

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In The Matter of

Implementation of the
Pay Telephone Reclassification
And Compensation Provisions of the
Telecommunications Act of 1996

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CC Docket No. 96-128

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COMMENTS OF THE COMPETITIVE
TELECOMMUNICATIONS ASSOCIATION

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SUMMARY

This is the Commission's third attempt to craft a reasonable mechanism to ensure fair compensation for payphone-originated calls. Its previous two attempts failed for the same reason: that there is no connection between a presumed market rate for local coin calls and a fair compensation amount for access code and subscriber 800 calls. In this second remand proceeding, the Commission should not repeat the mistakes of its previous attempts. It should not look to this remand as an exercise to gather evidence to prop up its faulty compensation mechanism. The problem with the local coin approach is much more fundamental than that the FCC failed to adjust the default rate by a few pennies, or that it needs to explain itself better.

The Court of Appeals asked two questions which underscore the futility of using the local coin rate. First, it asked whether costs and rates would converge in the local coin market, such that the "market rate" is a reasonable approximation of coin costs. On this point, the evidence strongly suggests that costs and rates do not converge in local coin calling. Since the deregulation of local rates, all major PSPs have increased their local coin rates to \$.35 per call. This rate is uniform across PSPs and across the nation, demonstrating that cost differences among PSPs or among geographic regions do not affect coin rates. If costs and rates converged, however, one would expect evidence of that through variations for cost differences such as these.

Second, the Court asked whether there is any relationship between the local coin market and the market for access code or subscriber 800 calls such that the coin rate can be a surrogate for these calls. There are substantial differences between the local coin market, on the one hand, and the subscriber 800 and access code markets, on the other. Most critically, there is a difference between the two markets in both the buyers and in the manner in which each can react to market dynamics. As a result, these markets will not move in tandem, and are not linked in

the manner presumed by the Commission. Indeed, application of the FCC's long-standing "like services" test confirms that the local coin market is different from the access code and subscriber 800 markets.

Accordingly, the Commission must adopt a new approach to determining a fair compensation amount. CompTel supports the adoption of one of two alternatives to establishing fair compensation. If the Commission is committed to creating a market-based compensation rate, it should do so by creating a market directly, through the adoption of the "caller pays" approach. This is the only true market solution to establishing compensation. Short of adopting caller pays, the Commission should set a reasonable cost-based compensation amount. Cost-based compensation – not the pot of gold PSPs are chasing—will best promote Section 276's twin goals of promoting competition among PSPs and of promoting the widespread deployment of payphone services beneficial to the public. Based on the data available in the record concerning LEC payphone costs, a cost-based compensation amount that is reflective of the entire payphone industry would be in the range of \$.10 to \$.15 per call.

TABLE OF CONTENTS

SUMMARY	i
I. BACKGROUND	1
II. THE COMMISSION SHOULD ABANDON ITS FUTILE ATTEMPT TO ESTABLISH COMPENSATION USING THE LOCAL COIN RATE.....	5
III. THE LOCAL COIN RATE DOES NOT REFLECT PSP COSTS IN COMPLETING LOCAL CALLS.....	9
A. DEREGULATION HAS INCREASED COIN RATES TO 35 CENTS WITHOUT ANY NOTICEABLE CHANGE IN PAYPHONE DEPLOYMENT	9
B. THERE IS NO EVIDENCE THAT COSTS AND RATES CONVERGE IN THE LOCAL COIN MARKET	11
IV. THE MARKET FOR LOCAL COIN CALLS IS NOT A SURROGATE FOR ACCESS CODE OR SUBSCRIBER 800 CALLS	13
V. THE COMMISSION EITHER SHOULD CREATE A TRUE MARKET FOR ACCESS CODE OR SUBSCRIBER 800 CALLS OR SHOULD PRESCRIBE COST-BASED COMPENSATION.....	17
A. A SYSTEM WHERE THE CALLER DEPOSITS COINS TO MAKE AN CALL IS THE ONLY TRUE MARKET-BASED ALTERNATIVE	17
B. UNLESS THE COMMISSION MOVES TO CALLER PAYS, IT SHOULD ADOPT A COST-BASED COMPENSATION AMOUNT	18
CONCLUSION	19

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**COMMENTS OF THE COMPETITIVE
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The Competitive Telecommunications Association ("CompTel"), by its attorneys, respectfully submits the following comments on the issues remanded by the United States Court of Appeals for the District Columbia Circuit in *MCI v. AT&T* ("Payphone II").¹ The Commission should now abandon its futile attempt to use the local coin rate in its search for a "market-based" compensation amount. Rather, the Commission either should create a true functional market for subscriber 800 and access code calls or should set a cost-based rate using cost data reflecting reasonably efficient payphone providers.

I. BACKGROUND

This is now the third time that the Commission is attempting to craft a reasonable mechanism to ensure fair compensation to payphone service providers ("PSPs") for payphone-originated calls. Section 276 instructs the Commission to develop a plan that ensures PSPs are "fairly compensated" for calls originating from their payphones. As CompTel has emphasized

¹ *MCI Telecomm. Corp., et al. v. FCC*, No. 97-1675 (D.C. Cir. May 15, 1998).

throughout this proceeding, Section 276's goal is to ensure compensation that is fair to all parties – the PSPs receiving it, the carriers affected by it, and the consumers that ultimately must bear the cost of it. Fair compensation – not the pot of gold PSPs are chasing – will best promote Section 276's articulated goals of competition among payphone providers and the widespread deployment of payphone services *to the benefit of the general public*.² Compensation can undermine these goals just as much (if not more) by being too high as it can by being too low.

Twice now, the Commission has erred by prescribing grossly excessive compensation for subscriber 800 and access code calls. In the initial *Payphone Orders*,³ the Commission prescribed compensation at an amount equal to a presumed market rate for local calls (\$.35). The Court of Appeals vacated and remanded this decision, finding subscriber 800 and access code compensation “inexplicably tied to a local coin rate.”⁴ The Court rejected the Commission's sole ground proffered for connecting the two rates – that the costs of coin calls and compensable calls are similar. This premise simply did not square with the record, which the Court found “replete with evidence” that the costs of coin calls are higher than those of compensable, non-coin calls.⁵ Because of this difference in costs, the *Payphone Orders* “epitomize[d] arbitrary and capricious decisionmaking.”⁶ In a separate order, the Court clarified

² 47 U.S.C. § 276(b)(1).

³ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd 20,541 (1996), Order on Reconsideration, 11 FCC Rcd 21,233 (1996).

⁴ *Illinois Pub. Telecomm. Ass'n v. FCC*, 117 F.3d 555, 564 (D.C. Cir. 1997), *cert denied*, 118 S. Ct. 1361 (1998). (*Payphone I*).

⁵ *Id.* at 563.

⁶ *Id.* at 564.

that it vacated and remanded the decision because there was “little or no prospect of [the compensation rate’s] being readopted upon the basis of a more adequate explanation.”⁷

In response to the *Payphone I* remand, however, the Commission made only slight changes to its compensation plan. Purporting to address the differences in cost between a local coin call, on the one hand, and subscriber 800 and access code calls, on the other, the Commission reduced the compensation amount to \$.284.⁸ Critically, however, the decision on remand started once again with the local coin rate as a surrogate for subscriber 800 and access code compensation. While abandoning the claim that the costs of these calls are “similar,” the Commission nevertheless tied compensation to the local coin rate because “the majority of the costs associated with a payphone are joint and common costs.”⁹

This revised compensation amount fared no better than did the original rate. “Having examined the record thoroughly,” the *Payphone II* Court found the derivation of the \$.284 rate “plainly inadequate.”¹⁰ Although the Commission’s rate included an adjustment for differences in costs, and thus nominally responded to the words of *Payphone I*, it had completely missed the meaning of that decision. As the Court explained, “The Commission never explained why a market-based rate for coinless calls could be derived by subtracting costs from a rate charged for coin calls.”¹¹ This approach is wholly “unreasoned” if the FCC is subtracting one quantity from

⁷ *Illinois Pub. Telecomm. Ass’n v. FCC*, 123 F.3d 693 (D.C. Cir. 1997), *cert denied*, 118 S. Ct. 1361 (1998) (clarifying *Payphone I*).

⁸ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, (Second Report and Order) 13 FCC Rcd 1778 ¶ 42 (1997).

⁹ *Id.* ¶ 41.

¹⁰ *Payphone II*, slip op. at 11.

¹¹ *Id.* at 11.

another, logically independent, quantity.¹² Yet the Commission never established the connection between the coin rate and the compensation amount it sought to determine.

Importantly, the Court addressed, and rejected, two possible rationales for using the local coin rate. First, the Court found the FCC's reliance on the joint and common costs associated with payphones "utterly unhelpful."¹³ The presence of joint and common costs does not provide a basis for assuming that the market rate for coinless calls would follow the "market rate" for local coin calls. Second, speculating that the FCC "may have" based its reasoning on the premise that the market rate for coin calls would reflect the cost of those calls, the Court found this rationale insufficient to justify the new compensation rate.¹⁴ Not only did the FCC never expressly claim that local coin rates reflected costs (and, in fact, recognized that the existence of locational monopolies would prevent this), but it "never went through the steps" of connecting this premise with the revised compensation rate.¹⁵ Because the FCC never supported the derivation of its market-based rate, the decision was remanded once again.

On this second remand, the Commission should not repeat the mistake of the first. The Commission should not look to this remand record for evidence with which to prop-up its faulty compensation mechanism. The problem is much more fundamental than that the FCC failed to adjust the default rate by a few pennies, or that it needs to explain itself better.¹⁶ Instead, it should ask the same questions the courts did: Why, if the markets for local calls and subscriber

¹² *Id.*

¹³ *Id.* at 12.

¹⁴ *Id.* at 12.

¹⁵ *Id.*

¹⁶ The *Public Notice* appears to cling to the view that the Court requested only minor word changes. Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding, DA 98-1198 (June 19, 1998) ("Public Notice"). See *Public Notice* at 2

(continued...)

800 or access code calls are different, does it make any sense to tie the compensation rate for one to the “market rate” for the other? To do this, the Commission must confront the differences between local coin calls and coinless access code or subscriber 800 calls directly and with an open mind. It must be prepared to examine payphone compensation from first principles, to determine the method that best ensures “fair compensation,” without bias toward protecting the rationale that has twice been reversed by the courts.

II. **THE COMMISSION SHOULD ABANDON ITS FUTILE ATTEMPT TO ESTABLISH COMPENSATION USING THE LOCAL COIN RATE**

In re-examining payphone compensation, it is helpful to begin with an overview of payphone calling. A LEC or independent PSP installs a payphone only after obtaining the consent of the property owner at which the phone is located. A PSP typically agrees to compensate the property owner in the form of commissions. The level of these commissions varies (sometimes significantly) by location and the market power of the property owner. Competition in the payment of location commissions is the principal mechanism by which PSPs compete with each other.

Once a payphone is installed, a PSP generates revenue from calls originating from the payphone. According to call detail submitted by independent PSPs, approximately 70 percent of these calls are local coin calls.¹⁷ As a result of the initial *Payphone Orders*, the PSPs have complete discretion to determine the price they will charge for these calls. Not surprisingly

(...continued)

(characterizing the court opinion as remanding because the decision was “not adequately justified” and the FCC “failed to explain” certain issues.

¹⁷ APCC 1997 Remand Comments at Attachment 4.

given the large volume of calls involved, many PSPs have stated that they generally make the decision whether to install a payphone based on the expected revenue from local calls.¹⁸

Another category of revenue-producing calls for PSPs are 0+ calls. For non-BOC, non-GTE PSPs, revenue opportunities have long been generated from their ability to select the default carrier to whom 0+ calls would be routed.¹⁹ In some cases, PSPs act as interexchange carriers, and thus route 0+ calls to themselves. These PSPs earn profits through revenues generated from the processing of 0+ calls. In other cases, PSPs receive commissions from an unaffiliated interexchange carrier as compensation for selecting it as the default carrier for 0+ calls. In the initial *Payphone Orders*, the FCC extended to BOC PSPs the right to negotiate with interexchange carriers for the selection of a 0+ carrier.²⁰ Thus, all PSPs have the ability to generate revenues through the selection of a 0+ carrier from their payphones.

Importantly, many PSPs generate a second revenue stream from 0+ calls, in the form of “property-imposed fees” (“PIFs”). Many OSPs, in an effort to win the 0+ business, allow the PSP to select an amount, in addition to the 0+ carrier’s charges, that the PSP will impose for using the payphone. This charge, which is billed and collected by the OSP on the provider’s behalf, can be imposed as a flat fee per call or as a percentage of the 0+ charge. PIFs commonly can total \$1 or more per call.

¹⁸ See CompTel 1997 Remand Reply Comments at 7.

¹⁹ Under the AT&T and GTE consent decrees, the location owner, not the BOCs or GTE, had the right to select the 0+ carrier from these LECs’ public payphones. *United States v. GTE Corp.*, CIV. A. No. 83-1298 (HHG), 1998 WL 150815 (D. D.C. Dec. 23, 1988), *United States v. Western Elec. Co.*, 698 F. Supp. 348 (D.C. Cir. 1988). Resulting in part from this direct revenue stream for location owners, the BOCs and GTE typically were able to offer location owners lower commission payments.

²⁰ The 1996 Act freed GTE from the decree obligations which prohibited it from selecting the 0+ carrier.

PSPs also generate revenues from long distance calls placed using coins (“sent-paid calls”) and from directory assistance and other non-emergency calls placed from a payphone. As with 0+ calls, a PSP can generate revenues from sent-paid calls by completing the call through its interexchange network or by receiving commissions for selecting a 1+ carrier for the calls. For non-emergency calls from the payphone, the PSP may determine the price to be charged for the call.

As a result, for 80 percent or more of the calls placed from a payphone, the PSP has the ability to generate significant revenues to support its payphone operations. These revenue sources either are completely unregulated or are subject to only minimal regulation.

The remaining categories of calls – access code calls (including 1-800 access) and subscriber 800 calls – are the subject of this proceeding. For public policy reasons, PSPs are required to permit callers to dial access code calls (but not subscriber 800 calls).²¹ Section 276 permits the PSP to receive fair compensation for originating access code calls. Moreover, although there never has been any legal prohibition on PSPs charging for subscriber 800 calls, CompTel recognizes that Section 276 permits the FCC to prescribe a compensation amount for these calls also. However, given the extensive revenue streams available for the overwhelming majority of payphone calls, it is not necessary to maximize access code or subscriber 800 revenue in order to promote the payphone industry. Section 276 requires that compensation be reasonable, but not excessive (*i.e.*, be “fair”). Fair compensation for these calls completes the PSPs’ array of revenue sources, but it should not dominate the revenue stream.

Unfortunately, the Commission’s attempt to rely on the local coin rate appears to be driven by a mistaken belief that it must boost the payphone industry through new forms of

²¹ 47 U.S.C. § 226.

compensation. The local coin approach, however, grants PSPs a billion dollar a year windfall for calls which create no appreciable incremental cost to the PSP. There is no justification for granting such a windfall, particularly when the payphone business appears to be as healthy as it ever has been, regulatory disparities between LEC and non-LEC PSPs have been eliminated, and the FCC has expanded revenue discretion for all PSPs.

Moreover, as is amply demonstrated by the two appellate remands in this proceeding, the local coin approach relies on two critical, but ultimately unsupportable, propositions. First, the decision rests on the premise that the local coin rate is itself cost-based. Second, even if the local coin rate reflects coin costs, that rate cannot be a surrogate for subscriber 800 or access code costs unless the market for local calls and the market for subscriber 800 or access code calls were linked as well. As is shown in Sections III and IV of these comments, neither of these premises is true. Consequently, the Commission never will be able to justify a compensation mechanism that is tied, with or without adjustment, to the local coin rate.

This remand is an opportunity for the Commission to break out of the cycle of appellate reversals and adopt an approach to payphone compensation that is reasonable, fair to all parties, and legally sustainable. Rather than making cosmetic changes to a house whose foundation has always been weak and is crumbling rapidly, the Commission should abandon the local coin approach entirely. It should replace that program either with a true market alternative or with compensation that represents an efficient provider's cost, one that is representative of the payphone industry as a whole.

III. THE LOCAL COIN RATE DOES NOT REFLECT PSP COSTS IN COMPLETING LOCAL CALLS

The *Public Notice* seeks comment on a number of issues relating to the first of the two premises underlying the use of a local coin rate as a basis for compensation. As the Court noted, the Commission's previous orders assumed that the market rate for coin calls reflects the costs of those calls. Evidence available since the deregulation of the local coin rate demonstrates that this assumption is wrong.

A. Deregulation Has Increased Coin Rates to 35 Cents without Any Noticeable Change in Payphone Deployment

The *Public Notice* seeks comment on the level of competition in the payphone market since deregulation of the local coin rate, and the impact of such deregulation on the rates charged end users.²² Unfortunately, deregulation of the local coin rate has not produced competition in the local coin rate.

Instead, the only change as a result of deregulation is that consumers need more of it to place calls from payphones. Given cover by the FCC's declaration of \$.35 as the "market rate," coin rates quickly were raised to \$.35 per call. This increase is costing consumers over \$1 billion annually in additional payphone charges, without any increase in consumer benefits.

The uniformity of the coin rate increase illustrates that the nature of competition in the payphone industry does not include competition for the rates paid by end users from payphones. With varying degrees of fanfare, every LEC and major independent PSP increased their rates to

²² *Public Notice* at 2.

\$.35 from every phone.²³ This increase was constrained, it appears, only by the pace at which a PSP could send technicians into the field to reprogram payphones.²⁴ There does not appear to be any dissent among PSPs in this strategy, as one might expect if the market among payphone providers were competitive. Nor is there evidence of end user competition since deregulation, such as through "price wars" between neighboring payphones.

This evidence suggests that the locational monopoly is the norm, not the exception, in end user competition at payphone locations. Competition for location owners through the payment of commissions does not ensure that end user rates are competitive. Although the competition for these commissions is intense, the location owner has little incentive after selecting a PSP to keep end user rates down. To the contrary, because the location owner's commission typically is a percentage of revenue, the location owner has an incentive to cooperate with the PSP in increasing end user charges as much as possible. As a result, the PSPs' pricing tends to reflect more the limit of monopoly pricing power than the result of end user price competition.

Although PSPs frequently claimed in earlier phases of this proceeding that higher revenues would promote an increase in deployment of payphones, empirical evidence of this effect is lacking. PSPs have known since September 1996 that coin rates soon would be deregulated, and all major PSPs rapidly increased their coin rates to \$.35 after deregulation took

²³ See, e.g., *Warren Telecom Regulatory Monitor*, Nov. 17, 1997 (discussing Bell Atlantic, BellSouth, GTE, Southwestern Bell and PacTel increases); *Comm Daily*, May 11, 1998 (U S West); *Peoples Telephone Company*, SEC Form 10-K at 28 (85% of its payphones have been increased to date).

²⁴ Several PSPs noted that it would take some time to implement this change in all of their payphones.

effect in October 1997. However, the prospect of these new revenues has not encouraged them to deploy more phones. At least among the largest public PSPs, it appears that they are deploying new payphones (as opposed to increasing their base through acquisition) at approximately the same pace they had been prior to the new compensation rates.²⁵ Instead, consumers are paying approximately \$1 billion more for local payphone calls, but are receiving the same level of payphone service they received in the past.

B. There is no Evidence that Costs and Rates Converge in the Local Coin Market

Taking its key from one of the Court's express criticisms, the *Public Notice* asks whether the local coin rate reflects competitive market conditions and whether costs and rates converge in the coin call market.²⁶ This is, of course, critical to the assumption that the "market rate" for local calls will be a surrogate for local payphone costs, and in turn for the assumption that this rate can substitute for costs of non-coin access code and subscriber 800 calls. The evidence available since deregulation of the local coin rate contradicts the premise that costs and rates converge in the local coin market.

As discussed above, PSPs have uniformly increased their local coin rates to \$.35 in response to deregulation. If costs and rates converged in the local coin market, however, one

²⁵ Peoples Telephone, for example, increased its payphone base by 4,000 between the first quarters of 1997 and 1998, but only 1,400 were the result of new installations (the rest reflected acquisitions of other PSPs). Peoples Telephone, SEC Form 10-Q at 7 (filed 5/15/98). Similarly, Davel Communications, another independent PSP which purchased CCI in 1997 and has recently agreed to acquire Peoples, actually reduced its number of new installations in 1997. Davel Communications, SEC Form 10-K at 4 (1,933 installations in 1997 vs. 2,859 and 2,449 in 1995 and 1996, respectively) (filed 3/31/98). Although it has added 700 new installs in the first quarter of 1998, it is on a pace to add approximately the same number of phones it added in 1995. Davel Communications, SEC Form 10-Q at 16 (filed 5/15/98). Data on LEC PSP installations for 1997 are not available.

²⁶ *Public Notice* at 2.

would expect significant variances in the local coin rate. These variances should exist, but do not, by geography, by density of payphones, and by PSP.

If costs and rates converged, one would expect coin rates to vary by geographic region of the country, because costs vary by region. Payphone access line charges are not uniform nationwide, and instead can vary significantly from one LEC to another. In addition, installation costs vary by the type of enclosure needed to protect against the elements. As a result, areas with more severe weather conditions and more outdoor locations should result in higher costs than mild regions or regions in which more payphones are shielded by other structures. Factors such as these should result in significant cost variances among payphones located in different regions, even where a single company operates in multiple regions. If the coin rate were reflective of these variances, it too would be higher in some regions and lower in others.

Because costs also can vary by type of location, one should expect to see variation in the rates charged at a given location. For example, some locations have higher instances of vandalism and other damage to the payphone, which would make those phones more expensive to operate. Differences in enclosure costs should make indoor telephones generally cheaper than outdoor phones. Moreover, if substitutability of services were a significant constraint on payphone rates, one would expect coin rates to vary by phone location, because factors such as the proximity of other phones or the availability of alternative calling mechanisms would be different for each location.

For similar reasons, costs – and rates – should vary by PSP. Maintenance and field service costs can be significantly affected by the cost of labor. To the extent that PSPs have higher or lower than average labor costs, they should encounter different overall costs. Similarly, PSPs receive their equipment from different vendors, with different levels of

functionality and different prices. Thus, one would expect some PSPs to have a cost advantage over their competitors, which might result in lower overall coin rates. In addition, large LECs appear to be more efficient in their payphone operations, which should give them a price advantage over competing non-LEC PSPs.

All of these cost differences are real, and all must be reflected in the competition among PSPs. The fact that the local coin rate is uniformly set at \$.35 – regardless of PSP, geographic region, or the proximity of competing phones – suggests that the competition does not reflect these differences in coin rates. In other words, PSP costs do not converge with end user rates, at least not in the coin rate. Rather, cost differences are reflected in other aspects of competition among PSPs. Most likely, these cost differences are being reflected in the commissions that they offer to location owners for the right to install a payphone. That is where one sees the variation among providers or locations, not in the local coin rate.

IV. THE MARKET FOR LOCAL COIN CALLS IS NOT A SURROGATE FOR ACCESS CODE OR SUBSCRIBER 800 CALLS

Regarding the second premise essential to the compensation schemes remanded by the courts of appeal, the *Public Notice* asks for comment on the similarities and differences between the markets for coin and coinless calls and the factors attributable to those differences.²⁷ It also asks whether and how those differences should affect the determination of a default compensation level for subscriber 800 and access code calls.²⁸ As shown below, the local coin and coinless markets are substantially different, with different actors and market dynamics for

²⁷ *Public Notice* at 2-3.

²⁸ *Id.*

each. These differences preclude the use of the local coin rate as a surrogate for coinless compensation rates.

In the local coin market, the PSP is offering an end-to-end service to a caller. The PSP is the supplier of the service, and the caller is the buyer. The buyer chooses whether to place the call, based on factors such as the price for the call, the availability of change, and the convenience of using the phone at that time. Critically, at the time of the purchase decision, the buyer knows the rate to be charged and has the ability to determine on a case by case basis whether to place the call (and therefore incur the charge).

In the access code and subscriber 800 markets, the market players and market dynamics are very different. Here, the PSP is not the provider of the telecommunications service; it only provide the ability to originate a call. Likewise, the buyer of an access code or subscriber 800 service frequently is not the caller placing the call. For subscriber 800 calls, the buyer is never the caller, but is the called party. For access code calls, the buyer can be the calling card holder (in the case of a card call),²⁹ the called party (collect calls) or a third party (third number billed calls).

In contrast with the operation of the local coin market, the caller making an access code call is not subject to the same price signals as when the caller places a local call. First, where the caller is not the buyer, he is not price sensitive at all. The true buyer in this situation does not have the same ability as the local caller does to control when and where the call originates.³⁰ Second, even when the caller is also the ultimate buyer, the market dynamics are changed by the

²⁹ The card holder can be, but is not always, the caller.

³⁰ The buyer does not have the ability to block calls on a case by case basis, and thus cannot make the same choices as a caller can. Even where the buyer can reject all payphone calls, the "all or nothing" choice available to the buyer does not mirror the choice a local coin caller can make.

indirect nature of the payphone charge. The caller does not pay the PSP directly, may not be aware of the charge, and is not affected by the same factors that are present in local calling.

Due to these differences in suppliers, in buyers, and in the functioning of buying decisions, the markets for local coin calls and for subscriber 800 or access code calls will not operate in the same manner. Changes that can affect the local coin market, such as the availability (or lack thereof) of sufficient coins, will not affect the access code or subscriber 800 markets. Similarly, the factors that an IXC or 800 subscriber would weigh to determine whether to accept a payphone-originated call are not the same as those that would be weighed by the caller in a local coin situation. Therefore, the local coin market will not reflect a market for access code or subscriber 800 calls. It cannot be used as a surrogate for the market price of those calls.

That the markets for local calls and subscriber 800 or access code calls are different is confirmed by application of the “like services” test the FCC uses to assess claims of unlawful discrimination under Section 202(a) of the Act. When evaluating a Section 202 discrimination claim, the Commission first looks to determine whether the two services are “like” one another.³¹ In this inquiry, the Commission determines whether the two services are “different in any material functional respect.”³² It evaluates both the nature of the services provided as well as customer perceptions of the functional equivalency of the services.³³

Applying this test to payphone calls, it is clear that a local call is not “like” origination of either an access code call or a subscriber 800 call. First, the functional characteristics of the calls

³¹ *Ad Hoc Telecomm Users Comm. v. FCC*, 680 F.2d 790, 795 (D.C. Cir. 1982); see *AT&T Communications, Revisions to Tariff* FCC No. 12, 6 FCC Rcd 7039 (1991).

³² *Id.*

³³ *Id.*

are different. A local call offers end-to-end call completion, whereas origination of an access code or subscriber 800 offers only a portion of a call. In addition, the destination points for the services are different: local calls offer termination only within a close geographic area, while access code and subscriber 800 calls can be completed to any location. Second, customer perceptions are different. Local calls are not functionally equivalent to access code or subscriber 800 calls, and customers can perceive the differences. No customer will approach a payphone indifferent to whether he will place a local call or an access code call. These differences only underscore that local calls are not a surrogate for access code or subscriber 800 calls.

The presence of joint and common costs in the provision of payphones does not overcome the fundamental differences among these markets. As the Court concluded, the mere existence of joint and common costs is “utterly unhelpful,” for it does not explain why the “market rate” for a coin call, even if certain costs are deducted, would be the same as the market rate for a coinless call.³⁴ That is, there is nothing about the presence of joint and common costs that guarantees the markets will move in tandem.

Indeed, the “joint and common cost” rationale proves too much. It is true for all payphone calls that these joint and common costs exist. If the existence of these costs linked the rates of payphone calls, then the local coin rate would be linked to other types of payphone calls, not just subscriber 800 or access code calls. However, there is no evidence that the market rate for a 0+ call, for example, moves in tandem with the market rate for a local coin call. Similarly, if joint and common costs linked payphone calls, a relationship should exist not only between the coin rate and other types of calls, but between any two types of payphone calls. Yet, all evidence indicates these markets operate independent of one another. Accordingly, there is no basis for

³⁴ *Payphone II*, slip op. at 12.

concluding that the local coin market is a surrogate for any other type of payphone calling market, including coinless calling markets.

V. **THE COMMISSION EITHER SHOULD CREATE A TRUE MARKET FOR ACCESS CODE OR SUBSCRIBER 800 CALLS OR SHOULD PRESCRIBE COST-BASED COMPENSATION**

Rather than attempting to support an unsustainable local coin approach, the Commission should revise its course and prescribe compensation on a new basis. The Commission has several rationales it may choose from to arrive at “fair compensation.”

A. **A System Where the Caller Deposits Coins to Make an Call is the Only True Market-Based Alternative**

If the Commission is committed to creating a market-based compensation rate, it should do so on the basis of a market that can actually work, not on a surrogate market that bears no relationship to coinless calling. Fortunately, a direct market in coinless calls is available to it. Specifically, if the Commission wishes to establish a market approach to compensation it should adopt the “caller pays” approach suggested by many commenters in this proceeding. The caller pays approach aligns the seller (the PSP) and the buyer (the caller) in a direct transaction, which sends the proper price signals for a functioning market.

Supporters of caller pays have shown that this approach is consistent with statutory principles, is feasible, and is the least costly method of administering payphone compensation. As *Payphone I* made clear, it is within the Commission’s discretion to adopt or reject caller pays as a fair compensation method. If the FCC is committed to a market approach to compensation, CompTel urges the Commission to reconsider the caller pays option. At a minimum, the FCC

cannot adopt a different market-based approach without explaining why that approach reflects the market for coinless calls better than caller pays would.

B. Unless the Commission Moves to Caller Pays, It Should Adopt a Cost-Based Compensation Amount

Unless the Commission adopts the caller pays approach, it should set a fair compensation amount using reliable and representative cost information. Cost-based compensation is fair, is consistent with Section 276, and will promote the widespread deployment of payphones and of payphone services to the public. CompTel has always favored a cost-based approach as the most reasonable and fair to all parties. The Commission should adopt that approach now.

It is critical, however, that the cost-based approach reasonably reflect the costs of the payphone industry as a whole. In the *Second Report and Order*, the Commission purported to calculate an alternative “bottom-up” cost for payphone calls, but that cost figure was reached only by systematically ignoring LEC cost data and by inflating costs to reflect a hypothetical “low volume” payphone.³⁵ Neither adjustment appropriately reflects the costs of the payphone industry as a whole. Moreover, even though the Commission conducted this calculation, it (rightly) never relied upon it.³⁶ Thus, in conducting a cost analysis on remand, the Commission should reject its previous calculation and conduct it anew using proper data and proper assumptions.

Any cost analysis must reflect the fact that LECs operate approximately 75 percent of the payphones in the nation. These LECs, many of which are several times larger than the largest independent PSP, also appear to be more efficient than the average independent PSP. Data

³⁵ *Second Report and Order* at 99, 118.

³⁶ *Id.*

illustrating the LECs' substantially lower costs has been presented in several forms in the record, including analyses of the Sprint LECs' costs,³⁷ of Bell Atlantic's cost of operating payphones in Massachusetts,³⁸ and of SBC's Southwestern Bell Telephone payphone division.³⁹ This data shows that the cost of originating access code and subscriber 800 calls is in the range of \$.10 -.15 per call, far below the compensation that the Commission previously prescribed. Relying on this and any other reliable data submitted in this proceeding, the Commission should set a cost-based compensation amount of no more than \$.15 per call.⁴⁰

CONCLUSION

For the foregoing reasons, the Commission cannot sustain a compensation amount that is based in any manner on the local coin rate charged by PSPs. The local coin approach is not a surrogate for the costs of coinless calls because (1) there is no evidence that costs and rates converge in the local coin market and (2) the local coin market operates independently of the access code and subscriber 800 calling markets. Accordingly, the Commission should abandon its attempt to establish "market-based" compensation using the local coin rate.

In replacement for the discredited local coin approach, CompTel suggests compensation determined using one of two alternatives. First, if the Commission is determined to establish market-based compensation, it should adopt the caller pays approach, because that is the only approach that establishes a true market for access code and subscriber 800 calling.

³⁷ Sprint 1997 Remand Reply Comments at Exhibit 1.

³⁸ Sprint 1997 Remand Comments at Exhibit A.

³⁹ AT&T Petition for Reconsideration, Robinson Aff. at Attachment I.

⁴⁰ Although CompTel recommends a cost-based compensation amount, it notes that the only evidence of a market rate for either type of compensable call is the \$.25 per call compensation amount AT&T and APCC negotiated for access code calls. CompTel does not object to using this market evidence, with adjustment to reflect the different market characteristics of subscriber 800 calls, in the calculation of a compensation amount. See AT&T 1997 Remand Reply Comments at n. 12-14.

Second, the Commission should set cost-based compensation using reliable data representative of the payphone industry as a whole. This compensation would not exceed \$.15 per call.

Respectfully submitted,

THE COMPETITIVE TELECOMMUNICATIONS
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A handwritten signature in black ink, appearing to read "Steven A. Augustino", written over a horizontal line.

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